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The next step in tax reform

Ithaca, N.Y.

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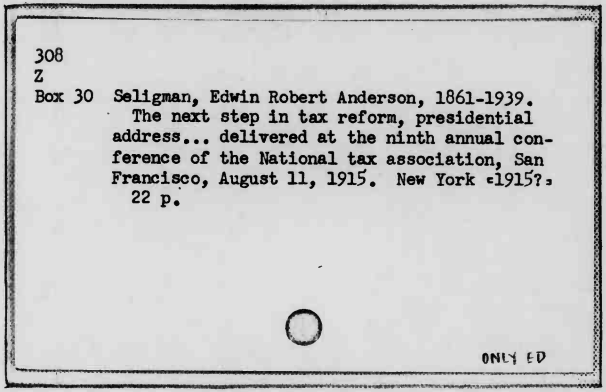
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NATIONAL TAX ASSOCIATION

The

Next Step in Tax Reform

PRESIDENTIAL ADDRESS OF

EDWIN R. A. SELIGMAN, LL.D.

DELIVERED AT THE NINTH ANNUAL CONFERENCE
OF THE
NATIONAL TAX ASSOCIATION
SAN FRANCISCO, AUGUST 11, 1915

NATIONAL TAX ASSOCIATION
ITHACA, NEW YORK

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ANNUAL ADDRESS OF THE PRESIDENT

THE NEXT STEP IN TAX REFORM

EDWIN R. A. SELIGMAN

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WE have been discussing for many years, the problem of the reform of our state and local system of taxation. While there has been no complete agreement as to the remedy, there has been a virtual unanimity in the diagnosis of the disease. The three fundamental shortcomings of our present system, apart from many minor evils, are recognized to be the persistence of the general property tax as the sole or principal source of revenue; the system of purely local assessment; and the utilization of the real estate tax for both state and local purposes. By far the larger part of dissatisfaction with our system is referable to one or other of these facts. And it is a cheering sign of progress that whereas a decade or two ago, this analysis was recognized by only few students, still fewer officials and a very insignificant fraction of the general public in the most advanced industrial states, there is at the present day a widespread acceptance of its truth in almost every state of the union and in continually larger sections of the population.

As to the remedies, however, we have by no means progressed so far. On one point, indeed, it may be said, that there is now also almost complete unanimity—namely, the necessity of central fiscal administration or at all events of greatly increased central control over the local administration. The accuracy of this statement is attested by the recent creation of the numerous state tax commissions which have been, and still are, doing such admirable work in improving fiscal conditions. But further than that, we have scarcely gone.

In a few of our states indeed, which have been entirely untrammeled by constitutional restrictions, the old general property tax has been supplemented by specific taxes—often loosely called indirect taxes—on corporations, inheritances and the like; and in a very few cases some particular categories of personalty have been taken out of the general property tax and treated in a special way. And in not a few states, the recent movement in the direction of tax reform has consisted in an attempt to modify the strict limitations of the constitution so as to permit of the introduction of this system of a classified property tax.

That the movement toward a classification of property for purposes of taxation is a step in advance will scarcely be questioned. For anything that releases us from dependence on the general property tax, as almost everywhere understood, is warmly to be welcomed. More recently, however, there has developed a situation which is calculated to give us all pause and to lead us to study the problem from a new point of view. What I refer to is the fact that in one of the most advanced states, New York, which was unhampered by its constitution, which had by law taxed certain kinds of personal property in a special way and at a special rate, and which had in practice well nigh exempted other forms of both tangible and intangible personalty,—in this state the need has recently arisen for a vastly increased revenue, for the purposes both of the state and of the City of New York. It is estimated that to put the state on a sound fiscal basis, an additional annual revenue of from at least twenty to thirty millions will be needed, chiefly in order to defray the interest and amortization costs of the large debt incurred, and hereafter to be incurred, for the enlargement of the Erie Canal and for the construction of an improved system of state highways. In the City of New York alone, a similar additional revenue of from twenty to thirty millions a year will be required partly because of the recent adoption of the pay-as-you-go policy of financing capital improvements, partly because of the exigencies of the Rapid Transit situation and partly because of the needed contributions to the state revenue.

The sudden injection of these additional obligations into

the New York situation have raised the entire problem in a much more acute form than anywhere else. For in most commonwealths where there is a movement toward a classified property tax, the problem is primarily one of justice in taxation. It is in a certain sense an ethical rather than a fiscal problem. It is not so much a question of securing more revenue as of substituting a superior for an inferior method of securing the same revenue—a revenue that might be expected gradually to increase with the progress of wealth and population. But in New York, where the old general property tax has in a large measure disappeared in practice and where the evils of unequal taxation, although by no means absent, are not so glaring or so acutely felt as in those states which still make the vain attempt to enforce the tax with rigor, the real problem is that of securing a greatly increased revenue, without imposing upon real estate a rate of taxation which would be so high as to be virtually confiscatory. It is of course, not intended to deny that the need of increased revenue is not being more and more strongly felt in other states; but in none of them, to my knowledge has such a crisis been suddenly precipitated upon an unprepared public.

This situation has caused a rude awakening to those who have always considered New York in the forefront of tax reform in that the Empire State has made greater progress than most of the other commonwealths in its practical departure from the old general property tax. The exigencies of the new situation have led to the appointment both of a State Legislative Committee and of a Mayor's Tax Committee in the City of New York, and are thus causing a reconsideration of the entire problem. According to the views commonly expressed, there are only two solutions; either the continuation of the present New York system, which would mean, in practice, an immensely increased tax rate on real estate; or, on the other hand, the attempt to tax in a greatly extended form those classes of tangible and intangible personalty which are now either taxed at an insignificant rate or not reached at all.

Whereas, therefore, in most of the states which still have the old general property tax, the movement toward a classi-

fied property tax might be welcomed as a means of escaping from an antiquated and increasingly unendurable system, in the city of New York which already has the new system in part, the problem arises as to whether we shall still further develop this new system or cut loose from it entirely. The problem in other words is not so much the superiority of a classified property tax over the old general property tax (which in practice no longer exists), as the relative advantages and disadvantages of a classified property tax compared not with the general property tax, but with something that is possibly better than either.

Regarded from this point of view, the shortcomings of a classified property tax are obvious.

In practice a classified property tax must be a low-rate tax on certain forms of personalty and especially of intangible personalty. Such a system has been in vogue for many decades in Pennsylvania. Here, however, we are told by the Pennsylvania Commission of 1911 that the low-rate tax on personal property has been only "more or less successfully collected." The sole part of the tax which has been a conspicuous success is stated to be the tax on mortgages. Yet in the state of New York any attempt to levy even a low-rate annual direct tax on mortgages would meet with the strenuous opposition of the real estate interests, large and small, at all events in all of the cities, because the experience of a decade ago has convinced everyone of the undoubted economic truth that under the conditions existing in New York a direct tax on mortgages is inevitably shifted to the borrower. The commission further tells us that "so far as Pennsylvania clings to the personal property tax in vogue, in other states, by attempting to tax other money investments, she undoubtedly suffers the same failure as the other states." The commission points out that securities as well as moneys on deposit are not reached "because there is no source of information except the honesty of the person making the return." In other words, the official verdict on the situation in Pennsylvania is that the low-rate tax on intangible personalty, apart from the tax on mortgages, is just about as much of a failure as the ordinary tax levied elsewhere on personalty.

In Connecticut, the low-rate tax on choses in action has been enforced since 1890. But, as everyone who is acquainted with the condition knows, it is almost a complete farce. In Baltimore, where the low-rate tax on certain intangibles has been administered by officials of remarkable ability, there is no pretense of any idea that real equality in taxation is attained or that great evasions are not practiced. In the State of Maryland at large the system is conceded to be a notorious failure.

Even in the states where the reform has been introduced more recently and where some encouraging progress has been made under the guidance of efficient permanent tax commissions, it is to be emphasized that the low personalty tax, whatever may be its advantages over the old general property tax, has not proved a conspicuous success as a source of large additional revenue. In Rhode Island, where the low-rate tax on intangibles was introduced in 1912 and where, as is natural, the assessment considerably increased, it is impossible to ascertain whether the revenue from this class of personalty is now more or less than before. It is to be observed, however, that, despite the notorious escape of intangibles before the enactment of the new law, the increase of the revenue from intangibles since 1911 has only slightly exceeded the increase in the revenue from real estate.[1] The statement of the tax commissioners in their first report for 1913, that the "beneficial results expected to be obtained are progressive, even under the most favorable circumstances" thus seems to be

[1] The figures are as follows:

	Assessment of		*State revenue from*	
	Real Estate	*Intangibles*	*Real Estate*	*Intangibles*
1912 . . .	$432,200,838	$96,758,872	$388,966	$87,092
1913 . . .	449,732,569	115,129,149	404,384	104,513
1914 . . .	459,653,296	123,953,431	410,016	111,630

The above figures of intangibles include only the intangibles locally assessed, and not the securities of corporations, trust companies and banks, which are subject to what are elsewhere called corporation taxes and which in Rhode Island were formerly, in part at least, subject to local assessment. It must also be remembered that the new law permits the offset for indebtedness against certain intangibles and not, as formerly against tangibles, thus reducing the taxable amount of intangibles.

borne out by the facts. In Minnesota, where the law was introduced in 1911 and where exact comparative figures are ascertainable, the revenue at first actually fell off; since then under an admirable administration the revenue has grown substantially but is still comparatively insignificant.[1] In the years 1911-1914 the assessment of intangibles increased from $115,676,126 to $197,625,914; but in the same period the assessment of real estate (exclusive of town and city lots) increased far more, namely from $664,930,374 to $872,296,355. And in 1914 the assessment of intangibles was still pitifully small when compared to the assessment of other property in general—the figures being 196 and 1,475 millions of dollars respectively. In fact the able tax commission tells us in their last report very frankly: "It is doubtful if the returns this year, large as they are, represent more than one third of what they should be."[2] Finally in Iowa, where the low-rate tax was introduced in 1911, the revenue is now undoubtedly much smaller than before. It is true that under the new law somewhat more "moneys and credits" are assessed: but as the new rate is only 5 mills the proceeds are actually much less. The exact figures are not ascertainable from the auditor's reports without laborious computation; but a member of the state tax commission states that the amount of revenue has been reduced at least one-half.[3] Whatever, there-

[1] The figures are as follows:

	Number assessed	*Assessment*	*Revenue*	
1910	$6,200	$13,919,806	$379,754	Rate averaged 28 mills
1911	41,439	115,481,807	346,445	three mill rate
1912	50,564	135,369,314	406,107	" " "
1913	57,068	156,969,892	470,909	" " "
1914	73,266	196,548,307	589,644	" " "
1915	73,062	212,134,901	636,404	" " "

[2] *Report of the Minn. Tax Commission*, 1914, p. 74. They add: "but we are making progress. . . . While we may never succeed in reaching all of the property, even under the present method, yet we believe, all things considered, that it is a decided improvement over the old general property system." In this conclusion every one will of course concur.

[3] Professor J. G. Brindley writes that "I am not able to give you a statement of the actual revenue derived. . . . But in view of the fact, that the listing of moneys and credits only slightly increased, the amount of revenue very materially decreased. . . . It is safe to say that the amount of revenue was decreased by at least one-half as a result of the new law."

fore, may be claimed for the low-rate tax, it does not seem probable that the amount of additional revenue which it would quickly yield would be its strong point. It is altogether likely that whatever the ultimate revenue might be, it would be slow in developing. It is hence questionable whether the scheme would be of advantage in the present crisis which confronts New York.

Moreover, while freely conceding the inestimable superiority of a classified property tax over the existing general property tax, it must be remembered that even if there were an entirely admirable administrative system in vogue, and even if the fiscal results were wholly satisfactory, there still are two considerations which should give us pause. The first is that under modern economic conditions no attempt to assess a tax on intangible personalty can ever be completely successful. The general property tax arose at a time when the economic unit was local in character and where it was entirely possible for the local administration to assess the property of the individual. The same was true to a large extent of the early conditions of American economic life, and it is still in part true of the more primitive of our rural communities. But under our modern industrial and capitalist development, the basis of personal property has become national or even international instead of local and the

The figures of assessment (not revenue) before and after the law are appended:

	Actual value of "moneys and credits"	*Actual value of "corporation stock"*	*80% of actual value of "bank stock and other moneyed capital"*
1910	$194,198,620	$35,019,729	
1911	170,131,195		$56,974,484
1912	188,773,772	4,702,325	62,887,044
1913	207,233,866	5,829,609	59,956,973
1914	250,218,178	5,845,207	63,301,915
1915	270,000,000	(approx.)	

The great changes between 1910-1912 are due to the fact that before 1911 much bank and corporation stock had been listed by the county assessors as "moneys and credits." The total assessments have therefore increased; but the revenue has suffered severely.

great mass of personalty is now of an intangible character. Under such conditions and especially where the old and still surviving political and legal considerations run athwart the economic facts, the attempt to reach intangible personalty meets with almost insuperable difficulties. Especially in communities like New York city, which are situated at the state border, the opportunities for evasion are singularly multiplied.

It will be replied that a low-rate tax will remove this temptation to evasion. It must be remembered, however, that even a four or five-mill rate represents in a large mass of securities an income tax of about 10%; and he would indeed be optimistic who holds that such a burden would not be appreciable, or would not lead men into temptation. Any system of taxation which needlessly multiplies the temptations to evasion is to be deprecated. Under the existing legal system in the United States, the conflict between location and residence in the matter of the taxation of personal property is indeed an irrepressible conflict. The result, even with the most admirable administration, is bound to be inequality and injustice.

But the second consideration is still more weighty. For the objection inheres in the very theory of the property tax. As I have had frequent occasion to point out, under modern economic conditions, property and especially personal property, is no longer a satisfactory index of tax-paying ability. Wealth in modern times is derived to a continually larger extent from relations, from opportunities, and from all manner of exertion more or less indirectly, or not at all, connected with property. Huge official salaries and large professional incomes are a common occurrence to-day and would go entirely free under a property tax. Individual and corporate profits derived from good-will, from franchises, from governmental favors and opportunities constitute an increasing flow of wealth which is either not at all, or only in part, incorporated into changes of capital value. Business men in general throughout the United States are slowly coming to the conclusion that their tax-paying ability is in no direct relation to their stock in trade. In certain classes of enterprise like mining and lumbering for example

it has come to be almost universally recognized that a system of taxation based on property is opposed to the best interests of the community as a whole.

I do not deny that in the case of real estate in general and especially in the case of city real estate, the advantages of an assessment of property are great; but it is to be remembered that in such cases every change in profits or yield is at once reflected in a change in the capital value of the property. As I have just pointed out, however, this consideration is true to a much smaller extent of the great mass of modern profits or incomes. To the extent that it is not true, property is losing its one-time value as a criterion of tax-paying ability.

It is largely for this reason that any kind of a tax on personalty would not be only unpopular but hazardous in a large center like New York City. Merchants' stock in trade is now virtually not taxed at all in New York. If it were to be assessed at what might appear to be even a comparatively low rate, there would be grave danger of its seriously interfering with the prosperity of New York as a manufacturing and jobbing center. For the stocks in trade of many businesses in New York are out of all proportion to their profits. And if in addition an attempt should be made to levy even a small tax on intangible personalty consisting of securities and bank deposits, it is clear that the financial dominance of New York might be very seriously menaced, because even a low tax on such property would be out of all proportion to the profits from the turnover of the property. What is true of New York City would come to be true before long in a corresponding degree of other large commercial and financial communities.

Let us recognize the fact then, once and for all, that a system of property taxation, except in so far as certain forms of real estate are concerned, is unsuited to modern economic conditions as the ordinary and principal source of revenue, however strong the arguments may be for its utilization in exceptional crises as during the present European conflict. Let us boldly face the situation and confess that while a classified property tax may constitute the only possible step in advance for those states that are still tied up by a rigid

constitution, the scheme is inapplicable to, or undesirable for, those states which are more fortunately situated from the constitutional point of view; and that even in the former class of states the energy that is being developed in the promotion of a classified property tax might more profitably be directed to what is at all events a more thorough-going remedy.

II

What then is this better remedy and what is the next step for states like New York. I have no hesitation at the present time in answering: the substitution of income for property as the basis of taxation.

This will perhaps come to many of you as a surprise from one who has uniformly resisted the introduction of a state income tax in the United States. I must beg, however, that you will remember several things. In the first place, I have now for more than twenty years been striving, as best I could, to call attention to the shortcomings of property as a theoretical basis of tax-paying ability. In the second place, I have always advocated the policy of taxing corporations on a net-receipts or income basis. Thirdly, I have always been in favor of a federal income tax in general and have contributed my modest share toward the elaboration of the present act. In the fourth place, my objection to a general state income tax has been almost entirely due to the belief that, with the administrative methods then almost uniformly in vogue, it would be just about as difficult to localize income for purposes of taxation as it has been, and still is, to localize property. It is for this reason that, while clinging to the conception of a personal tax on income for national purposes, I have devoted what little energy I possessed to the working out, in the various states of the Union and especially New York, of a system of real taxes or taxes on things instead of taxes on persons. But in the one case as the other my definite purpose was always to reach as far as might be income, or at all events the yield of the property, rather than the property itself.

Two events, however, have recently occurred to cause a reappraisement of the situation. In the first place, great

progress has been made in the direction of a centralized state administration. In New York we now have under the law of 1915 at all events a distinct step in the direction of more efficient fiscal administration. Of greater significance is the fact that the situation has been entirely altered by the introduction of the federal income tax. We have now gotten people, and especially business people, accustomed to an income tax; and while there are still grave problems to be solved and improvements to be secured, it may, I think, be stated, without fear of contradiction, that the income tax has come to stay and that in principle it is not seriously opposed by the community. With the existence of this new tax, which is successful so far as it goes, there arises the hitherto entirely unsuspected prospect of a state income tax being able to lean up against the federal tax, so as to avail itself of the federal returns and to be able in this way to minimize a great part of the difficulties which would otherwise attach to an independent state income tax.

This idea was present in my mind from the beginning. You may perhaps remember that partly in agreement with my suggestion a resolution was originally introduced into the United States Senate, recommending a distribution of a part of the proceeds of the federal income tax among the states. Further reflection, however, has convinced me that, while such a system would indeed be a simple solution, the political and administrative difficulties would be considerable, and that virtually the same result can be attained by a system of state income taxes, largely patterned upon the federal tax and utilizing as far as possible the federal returns.

An example of what I mean—and it is noteworthy as being the pioneer in this country—is the recent Connecticut law imposing a state tax on business corporations. When I was summoned in a few months ago by the Connecticut manufacturers to advise them, I found that they were all up in arms against the proposition to introduce into their state the Rhode Island system of corporate-excess taxation which had only recently been adopted there. It was my good fortune to be able to advise them as well as the legislature to prefer to any scheme of property tax a system of taxes on business

income based upon the federal law. Such a system was finally worked out by our accomplished colleague, Commissioner Corbin of Connecticut, and the result is a law whereby business corporations in Connecticut duplicate for state purposes the returns made by them to the federal government. Under this system an adequate revenue seems to be assured and the manufacturing interests appear to be entirely satisfied.

My suggestion, therefore, is that in New York as well as in other states which are ready for this next step, the entering wedge which we find in Connecticut should be pushed further in, and that an income tax should be assessed by the state tax commission according to a law which would be largely patterned on the federal act and which would require as far as practicable a duplication of the returns handed in to the federal government.

New York is in fact now even better fitted for the introduction of such a system than are some of the other states. For so large a part of all individual and corporate incomes are received in New York that even a very small rate would yield a large additional revenue. We know that New York pays about one-third of the entire federal income tax; and from figures furnished to me by federal government I have ascertained that in New York City alone there is paid almost one-half of the entire tax assessed upon individual incomes in the United States. Even therefore assuming that only an additional normal tax of one per cent were levied for state purposes and another one per cent for municipal purposes for New York City, the added revenues would, even with the deduction of all taxes paid at present on personal property, yield an income entirely adequate to the present and future fiscal needs of the state and city and would render unecessary the re-imposition of any so-called direct state tax. What is true of New York is true to a large extent of the other prominent industrial states; and even in the remaining states, which are ready for the next step of such an income tax, the income tax might, especially if the exemption were lowered, prove to be at least an acceptable substitute for the personal property tax.

The adoption of any such scheme would of course have to

be thought out very carefully. It depends in the first place for its success in no small measure upon an amendment to the present federal law, which it would probably not be difficult to obtain. This is to the effect that the so-called La Follette amendment which applies only to corporations should be extended to individuals. In other words, all returns to the federal government should be open, under pledge of secrecy, to the inspection of the officials of any state which imposes an income tax. In this way, an effective control would be furnished.

In the next place, the rate of taxation for state or for local purposes should be only the normal rate of one per cent. If a graduated scale were introduced, as in the federal tax, it might easily happen that the combined federal, state, and municipal taxes on large incomes would reach a figure which would probably be considered grievous or even confiscatory. Until public sentiment in the United States becomes accustomed to the far higher progressive rates which are now being levied in other parts of the world, it would be unwise to jeopardize the success of the scheme by the multiplication of graduated rates. A one-per cent tax for state purposes, or at the outside a two per cent part of which might be returned to the localities, would be as much as it would be prudent to add to the federal tax.

On the other hand, the high exemption which is now granted under the federal law ought to be reduced. The limit of exemption should certainly for state and local purposes, be brought down to at least $2,000, and perhaps even to $1,500. For whatever may be said as to the desirability of making large exemptions in the federal tax in order to serve as a make-weight to the internal revenue and tariff taxes, the argument would not apply to state and local taxation where there are few, if any, taxes on consumption. If, however, the limit of exemption were reduced, the revenue would be correspondingly augmented. Here again, the administration of the law would be greatly facilitated by an amendment to the federal act requiring all persons with a gross income (not a net income) not exceeding the minimum exemption to make returns. This would in all likelihood

render unnecessary few if any new or additional returns to the state officials, beyond the duplicates of the federal returns.

An important point is of course as to who should be subjected to such an income tax. This phase of the subject is really the most difficult. It has three different aspects: (1) affecting the residence of the taxpayer; (2) dealing with the proportion of income subject to state law; and (3) having reference to the relation of individual to corporate taxation. Let us say a word about each of these points.

All incomes are in last resort received by individuals, and, on the other hand, all incomes are derived either from property, from earnings apart from property, such as professional salaries, or from all kinds of exertions or relations which may or may not be connected with property and which are usually summed up under the general name of business. The difficulty arises from the fact that the source and the recipient of the income are not coterminous. The one may be within the state, the other without the state. In a federal income tax, these problems arise only in international relations and are of minor importance. But within the several commonwealths of a union or federation, the subject assumes grave dimensions.

From the ideal point of view an income tax might be considered as a strictly personal tax, and the recipient of the income would then pay a tax in accordance with the income received. But under existing conditions, both political and legal, such a theory is quite inapplicable to a state income tax. We should have the same difficulties that now confront us in the general property tax, where the controlling consideration is the legal residence of the tax-payer. It is therefore essential to adopt another theory of the income tax; the theory, that the tax is imposed not only on the recipient, but also on the source of the income, making provision as we shall see later, for the avoidance of double taxation. In other words, just as we sometimes speak of a property tax being imposed either upon the property or upon the property owner, so we can conceive of the income tax as a tax either on the income or on the recipient of the income. If the latter is called a tax on the person, the former may be called a tax on

the thing, that is on the income irrespective of the recipient. The one would be a subjective or personal tax, the other would be an objective or real tax.

This distinction is of the utmost importance, for it would otherwise be impossible for a state to reach incomes which are earned or derived with the state and which are finally paid over to individuals having a residence outside of the state. With this double conception of the income tax, however, which is in harmony with the jurisprudence of the subject as thus far elaborated in the United States, the solution of this particular difficulty is simplified. The income tax must be treated not only as a tax upon the incomes of legal residents of the state, but also as a tax upon all incomes earned or derived within the state, irrespective of the legal residence of the recipient. In the latter aspect it might be called a business tax; but I hesitate to use this term because it is not broad enough, and because the income may be received by someone who is technically not in business at all. I prefer the verbal distinction between a tax on the source and on the recipient of the income.

The practical result is that there would be subject to a state income tax not only all the persons legally resident within the state, but also all incomes earned or received within the state, whether these incomes are derived from property within the state, from business carried on within the state, or from relations or privileges existing within the state.

While the administrative difficulties of such a dual income tax would not be great, they would be largely diminished by another suggested alteration in the federal tax. In the first year of the operation of the federal law, returns were made by individuals at their place of business. In the second year, the option was given of making the returns either at the place of business or at the place of residence. It would be a comparatively simple matter for the federal law to require a return of the state or states where the income was derived as well as of the legal residence of the recipient. This would afford an effective control of the returns. In a metropolis like that of New York, for instance, where a large part of the income earned within the city is received by non-residents,

this problem is of special importance. Almost every important income tax in the world, it may be said, includes this double aspect of income.

It is obvious, however, that if we tax both incomes earned and incomes finally received with the state, some rule must be laid down as to the relative proportion to be taken by each taxing authority. We thus come to the second of the points, mentioned above. So far as the income from real estate is concerned, the problem need not give us any trouble, for under the accepted principles of American jurisprudence and of justice the income from real estate ought to be apportioned to the state of its location. In the case of business or corporate incomes, however, some method must be devised for taxing only so much of the income as is actually received or derived within the state. It is here that we shall need some federal law, or some decision of the federal supreme court, in order to bring about complete uniformity. As a matter of fact, several states including New York already apply the principle in the taxation of corporations by utilizing the criterion of proportionate mileage or proportionate assets or proportionate capital employed within the state. And as long as the principle of allocation is accepted, the exact method of devising a practical scheme may safely be left to the future.

If, however, the suggestion is adopted, permitting municipalities to levy an additional income tax under state law, or distributing to localities in general a percentage of the state income tax, it would become necessary to provide for a further apportionment of income within the states themselves. If New York city for instance, were to levy an additional income tax, the question would arise in the case of New York business men living in Westchester County, as to how much tax they should pay in New York. This should of course be a matter for state law to regulate; and almost any rough approximation to equality would be adequate. It might, for instance, be provided in the law that in such cases two-thirds of the tax should accrue to the place where the income is earned and that one-third should be handed over to the place of legal residence. The point of importance is that some adjustment must be made between the place of source and of the residence of the recipient.

The third point adverted to above is the relation of individual and corporate taxation. Here again we see the necessity of the dual conception of income. If the income tax be conceived of simply as a tax on the ultimate recipient, no tax at all on corporations would be legitimate. On the other hand, if the tax be considered one on the source of the income as well, a tax on the entire income of the corporation as well as on the entire income of the individual would mean a double tax on some of the security holders. The bondholder would indeed not be affected, nor would the preferred stockholder be touched by this simultaneous taxation. But the common stockholder would not only receive less dividends but pay a tax in addition on those dividends.

It might indeed be claimed that this is only apparent double taxation, because as soon as the tax was regularly and permanently imposed, there would be a corresponding fall in the market value of the shares, so that all new purchasers of the stock would virtually buy themselves free of the tax imposed on the corporation and would, like all other members of the community, be subject only to the personal income tax. This is indeed perfectly true. But in the interval, and while the original holders still own the property, the burden would be a sensible one. I should, therefore, suggest that where a state income tax is imposed, applicable as it ought to be to corporations as well as to individuals, the individual common stockholder should be exempt from the income tax on his dividends when, but only to the extent that, he should prove that he owned the stock before the imposition of the tax on the corporation. If, however, this should turn out to be administratively impracticable, a total exemption of dividends in all cases would be necessary.

Whether the income tax should be applied to corporations in those states which already have a fairly successful system of corporation taxes is a matter open to debate. In New York State, for example, ordinary manufacturing corporations are to a large extent, under the practical construction of the law, exempt from state taxation. I see no compelling reason why they should not be subject to a state income tax under the conditions mentioned above. So far as the public-

service corporations, however, are concerned, New York already derives a large revenue therefrom; and while there is no doubt that a reform of the state tax on corporations is entirely desirable, it might be just as well, in order not to multiply difficulties, to exempt them from the income tax. All corporations, however, are still subject in New York to local taxation on their entire property tax. The complications connected with this as leading to the adoption of the involved franchise tax are well known. It would be a great step in advance if there could be substituted for this local tax on personal property a local income tax to be assessed by the state board and to replace the franchise tax as well. This would greatly diminish the objections on the part of local communities which now derive a substantial revenue from corporate taxes. That in New York as well as in many other states the corporation taxes, both state and local, will ultimately be put on an income basis, I have no doubt. But as to the tempo of development, there may be reasonable grounds for discussion.

It is obvious from what has been said that it would be in every way desirable to abolish entirely the taxation of personal property and to have the income tax serve as a substitute therefor. If this is an impossibility for political or constitutional reasons, it would be well to consider the plan already adopted in Wisconsin, namely, to permit the deduction of any taxes paid by individuals on personal property from the sums due for income tax. This would, indeed, still necessitate the form of property assessment; but the result would virtually be the same. Moreover, the privilege which I have suggested of permitting localities to choose an additional income tax for local purposes, to be levied by the state, would put it entirely within the competency of each city, town or village to decide whether it preferred a continuance of the old general property tax, or a substitution of the new income tax. I should even go further, and if a local income tax proved to be politically impossible I should suggest that the municipalities be permitted, under general state regulation, to select as a substitute for the personal property tax an indirect income tax in the shape of a habitation and an

occupation tax. To this extent, I am in favor of local option—that is, the liberty on the part of localities to choose between methods of taxation which are definitely regulated by general state law and in such a way as to retain the control and the general supervision within the hands of central officials.

The adoption of this scheme, it will be recognized, will also accomplish all that is desirable in the plan of separation of sources. The controlling reasons for suggesting the separation of state and local revenue have always been to relegate the taxation of real estate to the localities and to provide for a centralized state administration of taxes on corporations, inheritances and the like. The adoption of a state income tax would really be in harmony with this scheme of separation; for real estate would be exclusively taxed by the local communities, while corporations and inheritances would be assessed by the state authorities. The mere fact that the income tax might be utilized for both state and local purposes would in reality not derogate from the principle involved. For the basis of the tax would still be a state basis, even though additions were permissible to the localities. I should not consider such a system as inimical to the real principle underlying the theory of separation of source, any more than I should consider the existing apportionment in part of the excise tax in New York or of certain corporation taxes in other states as inimical to the principle. Separation of source as I conceive, means primarily separation of the assessment of source.

From the above review it will be seen that, in my opinion, we are slowly but surely being pushed into a position where property is to be replaced by income as the chief basis of taxable ability. It is not likely that in the most advanced industrial states of the Union we shall revert to a discredited system. If in New York public opinion is not yet ready to declare itself in favor of such a revolution as is implied in the income tax it is entirely likely that we shall proceed for a time to follow the plan pursued for over a century by France, when she abandoned her old personal taxes—that is, of attempting to get at the income indirectly rather than directly by a series of taxes on things rather than on persons,—

such as habitation taxes, occupation taxes, business licenses and the like. For with the increasing burdens of modern life, it is fair to assume that real estate alone will not be permitted to endure the pressure. Until the recent adoption of the federal income tax, the outlook for a successful state income tax was exceedingly slight; now, however, the situation is entirely altered, and is full of promise.

There are only two points that I should like to emphasize in closing. The one is that if we are to utilize the income tax as a promising source both of greater revenue and of greater equality for state and local purposes, it is important that the rate of the federal income tax should be kept low. For if there should be a real competition between the federal and the state governments for the same source of revenue, the results could only be disastrous. This leads to the second point, that it behooves us to take up anew and from a broader point of view a reconsideration of the relative merits of direct and indirect taxes. With the well-nigh exclusive reliance of the states upon direct taxation, and with the growing tendency on the part of the federal government to emphasize the prevalence of direct taxation, there is in my opinion a grave danger of our overstepping the limit. All history has shown that a certain balance must be kept between direct and indirect taxes. As the great reformer Gladstone told us over a half a century ago, we must think of direct and indirect taxation as two attractive sisters, with the same parentage (necessity and invention), differing only as sisters may differ, in minor respects, and not justifying any unfriendly rivalry between their admirers. We are in my judgment in danger of losing that sense of impartiality, which so strongly animated that great statesman. We need in the domain both of federal and of state taxation to devote considerably more attention in the future to the possibilities of indirect taxation. For we shall otherwise not only complicate the situation but incur the danger of a serious reaction from the ensuing exaggerated burden of direct taxation; and shall render still more difficult this transition from property to income taxation which is impending in many of our states and which I have ventured to call the next great step in advance.

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